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No. 196

IN THE

Supreme Court of the United States

OCTOBER TERM, 1966

FRUEHAUF CORPORATION, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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PETITIONER'S REPLY BRIEF

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PETITIONER'S REPLY BRIEF

I

The respondent's description of the Commissioner's 1950 action as a decision "to permit petitioner to continue using" the $1 per unit method of inventorying used trailers (p. 3), or as a mere "acquiescence" in the use of such method (p. 4), or as merely yielding to petitioner's wishes (p. 7), would convey the impres-

sion that the Commissioner's action was a mere passive acceptance of the $1 per unit method. The facts of record are to the contrary. Almost two years prior to 1950 the petitioner and the Internal Revenue authorities in Detroit had reached a tentative agreement under which petitioner's used trailer inventories were changed to the lower of cost or market value method; and in accordance with that tentative settlement petitioner (1) changed its books of account to reflect used trailer inventory on the lower of cost or market value method, (2) filed a claim for refund for 1946, (3) filed an amended return for 1947, and (4) filed its original 1948 return, all based on the use of the lower of cost or market value method of inventorying used trailers (R. 104a, 106a, 113a, 114a). The decision which the Commissioner made in 1950 was to reverse the 1948 tentative settlement, and thus recompute petitioner's income taxes for the years 1942-1945 on the $1 per unit method. As a consequence, and in furtherance of that decision to require the continued use of the $1 per unit method, the 1946 claim for refund and the 1947 amended return were rejected, and the 1948 return was recomputed by the Commissioner by inventorying used trailers on the $1 per unit method. Suffice it to say that these facts demonstrate that the Commissioner's 1950 decision constituted a positive action and not mere passive acquiescence.

II

Respondent argues that petitioner has abandoned the position raised below and has now put forth a new contention. His memorandum in opposition states (pp. 4 and 5) that petitioner's sole contention in the court below was that the Commissioner's "acquiescence" in

1950 in the $1 per unit inventory method constituted a "legislative" determination which could not be retroactively changed in 1959, but that petitioner now contends that the Commissioner's 1950 decision was not a mistake of law and hence cannot be reversed retroactively.

The position which the petitioner takes in this Court is precisely the same as that which it took in the Court of Appeals. That position may be summarized as follows: Congress, in enacting Section 41 of the Internal Revenue Code of 1939, delegated to the Commissioner of Internal Revenue broad discretion in the accounting field, i.e., he was empowered to compute a taxpayer's net income "in accordance with such method as in the opinion of the Commissioner does clearly reflect the income." The authority thus delegated was something quite different from the authority to interpret the meaning of a particular statutory provision,—it endowed the Commissioner with a very wide discretion. Some courts and some text writers have labeled determinations or decisions taken under these two different powers as "legislative" and "interpretative," respectively. For example, in *Gibson Wine Co.* v. *Snyder*, 194 F. 2d 329, 331 (C.A.D.C. 1951) the Court said:

> "The distinctive characteristics of interpretative rulings, as contrasted with so-called regulations, have long been recognized. Administrative officials frequently announce their views as to the meaning of statutes or regulations. Generally speaking, it seems to be established that 'regulations', 'substantative rules' or 'legislative rules' are those which create law, usually implementary to an existing law; whereas interpretative rules are statements as to what the administrative officer thinks the statute or regulation means."

If the Commissioner makes a determination which erroneously interprets a statutory provision (an "interpretative" determination), such determination may be reversed retroactively, because it constitutes a mistake of law. But if the Commissioner makes a determination in an area where he is given a broad discretion, (a "legislative" determination), as in the accounting method area, such determination cannot be erroneous (unless it is an abuse of discretion). The position which petitioner took in the Court of Appeals was that the 1950 determination of the Commissioner requiring it to remain on the $1 per unit method was not a mistake of law and could not be reversed retroactively. This is the same position which petitioner takes here.

III

The respondent states (p. 6 of his memorandum) that "the Commissioner generally has the right to correct mistakes in a taxpayer's return for all past years which are not barred by the statute of limitations, even if the correction is a change of position on the Commissioner's part." This statement is valid enough as a general rule. The Commissioner may correct a decision which he has made with respect to a particular taxpayer in a particular year so long as the statute of limitations with respect to that year remains open, for until the statute expires any decision of the Commissioner remains tentative in character, *Burnet* v. *Porter*, 283 U.S. 230, and *McIlhenny* v. *Commissioner*, 39 F. 2d 356 (3d Cir. 1930), cited by respondent. This situation is not involved here. The Commission also may correct a mistake in a taxpayer's return for a year which is not barred by the statute of limitations, even though his ac-

tion is contrary to a determination made by him in an earlier year with respect to which the statute has run, if that earlier determination constituted a mistake of law. *Automobile Club of Michigan* v. *Commissioner,* 353 U.S. 180 and *Dixon* v. *United States,* 381 U.S. 68. But where the decision in the earlier year does not constitute a mistake of law, it may not later be reversed retroactively. *Woodworth* v. *Kales,* 26 F. 2d 178 (6th Cir. 1928), *H.S.D. Co.* v. *Kavanagh,* 191 F. 2d 831 (6th Cir. 1951).

IV

The respondent has failed to come to grips with the question that constitutes the crux of this case—Did the Commissioner act within his statutory discretion in requiring, in 1950, that petitioner remain on the $1 per unit method of inventorying used trailers? In fact, respondent appears to have studiously avoided either affirming or denying that, as petitioner contends, the Commissioner was acting within the limits of his discretion in requiring petitioner to remain on the $1 method, in order to protect the revenue, even though he found such method to be "obviously erroneous." (R. 109a). If he was acting within his authority, his exercise of discretion was not a mistake of law and may not be reversed retroactively.

The language of Section 41, Internal Revenue Code of 1939, required the Commissioner, whenever he found that a taxpayer's method of accounting did not clearly reflect income, to compute net income "in accordance with such method as in the opinion of the Commissioner does clearly reflect the income." His duty to see to it that income was clearly reflected, even to the extent of requiring a taxpayer to remain on an erroneous

method of accounting to protect the revenue, did not, as respondent suggests in footnote 6 on pages 8 and 9 of his memorandum, depend upon whether the taxpayer did or did not request permission to change his method. If the exercise of this duty by the Commissioner was subject to a higher duty, to protect the revenue, in cases where a change in method was requested by a taxpayer, then surely the paramount duty to protect the revenue fully justified the Commissioner in requiring the petitioner to remain on an erroneous method of accounting.

The determination made by the Commissioner in 1950 required the petitioner to remain on the $1 per unit method and to continue using such inventory method unless the petitioner requested and obtained permission to change. (Regulations 111, Section 29.41-2). The petitioner never requested permission to change, and there is no requirement in the Internal Revenue Code which obligated it to initiate a change in any method of accounting under such circumstances. Accordingly, the petitioner was required to continue to use the $1 per unit method, even though it was an erroneous method, until it was notified by the Commissioner of his intent to change such method to a correct method for future years.

If, as petitioner contends, the Commissioner was acting within the scope of his discretion in requiring, in 1950, that petitioner remain on the $1 per unit method of inventorying used trailers, such action was within the power given him by statute, and hence could not have been a mistake of law. If it was not a mistake of law, the Commissioner's 1950 determination may not be reversed in 1959 retroactively to 1954.

The important question here is: Did the Commissioner act within his discretion? The decisions of the Second Circuit in *American Can Co.* v. *Commissioner*, 317 F. 2d 604 (1963), and *In re Sperling's Estate*, 341 F. 2d 201 (1965), of the Third Circuit in *Commissioner* v. *O. Liquidating Corp.*, 292 F. 2d 225 (1961), and of the Court of Claims in *John Wanamaker Philadelphia, Inc.* v. *United States*, 359 F. 2d 437 (1966), require an affirmative answer, contrary to the decision of the Court of Appeals for the Sixth Circuit in the instant case, and we submit that this question should be finally determined by this Court

Respectfully submitted,

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